

TABLE OF CONTENTS

	PAGE
EXECUTIVE SUMMARY Click Here To View	i
INTRODUCTION	1
BACKGROUND	2
Nature Of Special Assessments	2
Program Information	2
The Special Assessment Process	5
Bond Financing	7
Collection Of Assessments	8
Payment Of Interest And Maturing Bonds	8
Distribution Of Earnings And Fund Surplus	9
Accounting For Transactions and Cost Reimbursements	10
SCOPE AND METHODOLOGY	11
FINDING I - ELIMINATING NEGATIVE CASH BALANCES IN SPECIAL ASSESSMENT DISTRICT FUNDS WOULD INCREASE OTHER CITY FUND INTEREST EARNINGS	12
Special Assessment District Funds And The City's Investment Pool	12
Negative End-Of-The-Month Debt Service Cash Account	13
Reduced Earnings For Other City Accounts	15
Inadequate Special Assessment District Accounting And Administrative Procedures And Timing Of County Remittance Of Collections Cause Negative Balances In Debt Service Cash Accounts	15
Accounting And Administrative Procedures	16
Timing Of County Remittances	19

CONCLUSION	21
RECOMMENDATIONS	22
FINDING II - AUTOMATING ENTRY OF CASH ACCOUNT BALANCES TO THE MONTHLY INTEREST DISTRIBUTION REPORT WILL IMPROVE EFFICIENCY AND REDUCE THE POTENTIAL FOR ERRORS	23
The Monthly Interest Distribution Process	23
Opportunities To Automate Entry Of Cash Account Balances To The Interest Distribution Report	24
Advantages Of Automating Entry Of Cash Account Balances To The Interest Distribution Report	24
CONCLUSION	25
RECOMMENDATION	25
FINDING III - WRITTEN PROCEDURES ARE NEEDED REGARDING ARBITRAGE FOR SPECIAL ASSESSMENT DISTRICT BONDS	26
The Tax Reform Act Of 1986	26
Current Administration Investment Practices	27
CONCLUSION	28
RECOMMENDATIONS	29
FINDING IV - OPPORTUNITIES EXIST TO ELIMINATE GENERAL FUND FINANCIAL RISK WHEN ESTABLISHING IMPROVEMENT DISTRICTS	30
Inconsistent And Insufficient Developer Deposits	30
District Financing In Other Cities	35
Expenses Incurred On Unapproved Projects	35
CONCLUSION	37
RECOMMENDATIONS	37

FINDING V -	
IMPROVED MONITORING COULD ALLOW THE GENERAL FUND TO RECOVER AN ESTIMATED ADDITIONAL \$100,000 PER YEAR IN SPECIAL ASSESSMENT DISTRICT ADMINISTRATIVE COSTS	39
Functional Phases Of Special Assessment Projects	40
Debt Service Administrative Activities	40
Debt Service Revenues And Costs	41
Criteria For Cost Control And Recovery	43
Accounting For Special Assessment District Administrative Costs	43
Legal Status Of Surcharges	43
Restricted Cash-Paying Agent Accounts	44
CONCLUSION	45
RECOMMENDATIONS	46
OTHER PERTINENT INFORMATION.....	48
ADMINISTRATION'S RESPONSE Click Here To View	51
APPENDIX A Click Here To View	
DEFINITION OF PRIORITY 1, 2, AND 3 AUDIT RECOMENDATIONS.....	A-1

INTRODUCTION

In accordance with the City Auditor's approved 1987-88 Workplan, we reviewed the City's Special Assessment District Formation and Financial Processes. We conducted our review in accordance with generally accepted government auditing standards and limited our review to those areas specified in the Scope and Methodology section of this report.

BACKGROUND

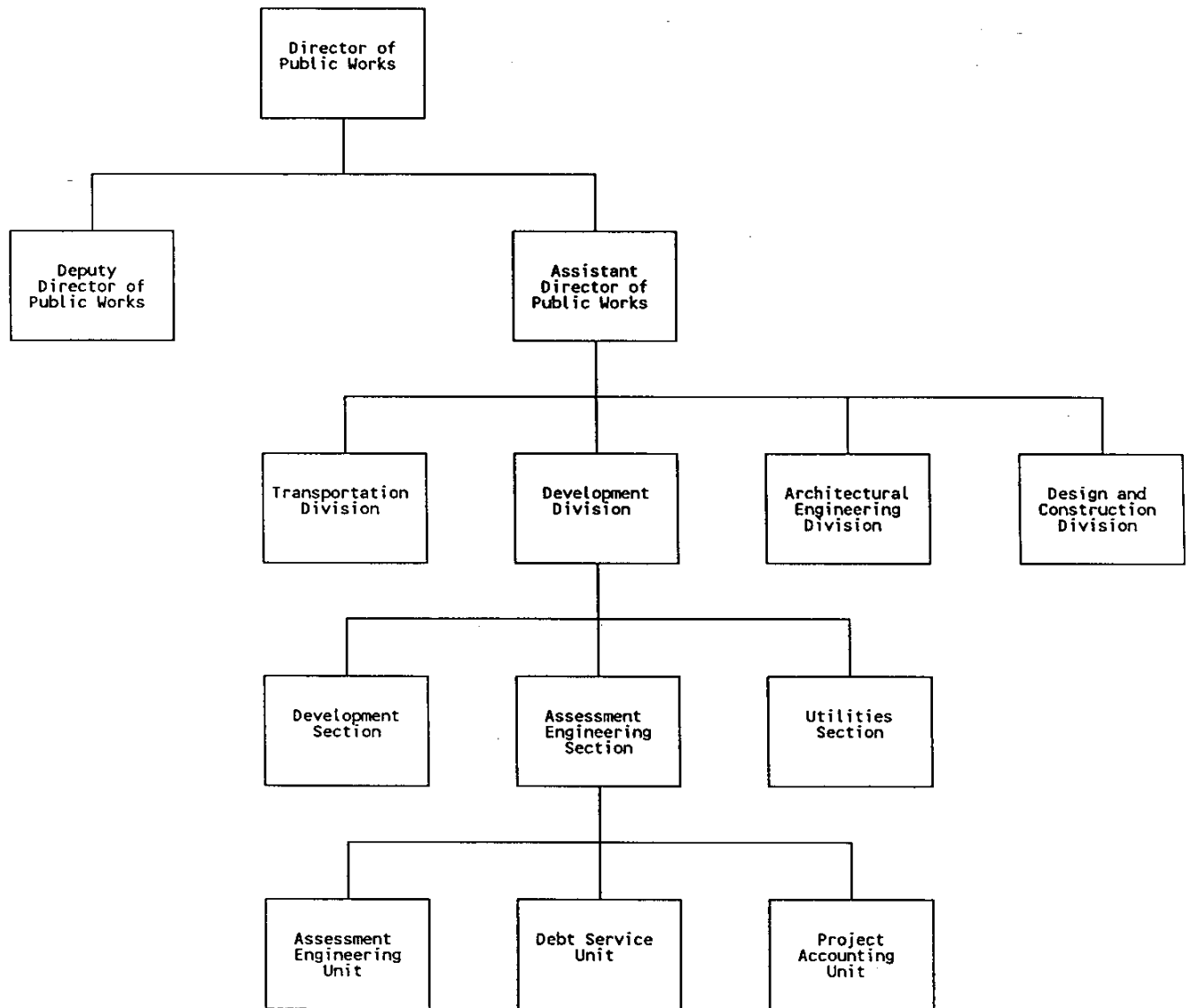
Nature Of Special Assessments

A *Special Assessment* is a special charge or exaction that a municipal authority levies to provide and finance public improvements or services. The landowner against whose property the charge is levied is the primary beneficiary of these improvements or services. The limited geographical area which benefits from the public improvements or services and is assessed the charge is called a *Special Assessment District*. A special assessment district may be either an *Improvement District* or a *Maintenance District*. An *Improvement District* is created to construct or install public improvements. A *Maintenance District* is created to preserve, enhance or repair existing public improvements. Authorized public improvements may include roads, streets, curbs, gutters, sidewalks, sanitary sewers, storm drains, or trees and ornamental vegetation. In addition, public utility facilities for supplying electricity, gas, water and other conveniences can also be public improvements.

Program Information

The *Public Works Department* is primarily responsible for the City's special assessment activity. Specifically, the *Assessment Engineering Section* of Public Works performs the special assessment activity. The Section is made up of three units: the *Assessment Engineering Unit*, the *Debt Service Unit*, and the *Project Accounting Unit*. The Section is organizationally located within the Public Works Department as shown below:

PUBLIC WORKS DEPARTMENT
ORGANIZATION CHART



(Source: Public Works Department)

The Assessment Engineering Section:

- performs assessment district engineering and inspection,
- confirms maintenance district assessments and repair assessments,
- prepares the payment schedules of annual principal and interest installments for each parcel of property in new improvement districts,
- performs assessment segregations whenever a parcel is split into two or more new parcels, and
- reviews delinquent accounts and arranges with City Attorney for foreclosures on delinquent assessments.

As of March 1, 1988, the Assessment Engineering Section was authorized 21 full-time positions. Of these, five positions were assigned to perform accounting and other debt service administrative activities. A review of the three-year staffing costs for the five positions shows the following budgeted costs:

1986-87	\$205,090 ¹
1987-88	\$220,494
1988-89	\$232,382

(Source: Public Works Department)

The Finance Department also performs special assessment activities. These activities include:

- selling bonds,
- investing idle cash,

¹ See FINDING V for a discussion of the cost recovery rate on Special Assessment Debt Service Administrative Activities.

- distributing earnings to assessment funds,
- remitting funds to Fiscal/Paying Agent for paying debt service,
- paying for construction projects, and
- accounting for all assessment fund transactions.

As of June 30, 1988, the City maintained 78 improvement districts and 16 maintenance districts. An additional four districts are currently in the formation process.

The revenues generated by Special Assessment District Funds over the past five years show the following decreasing trend:

1983-84	\$25,369,809
1984-85	\$26,265,655
1985-86	\$21,071,871
1986-87	\$18,134,606
1987-88	\$14,161,376

The Special Assessment Process

Property owners (usually developers) who wish to use special assessment financing to construct public improvements on their property start the process by having the Development Division of Public Works evaluate their project. The Division reviews the project for conformance with zoning requirements and master plans for the project area and negotiates the conditions and requirements for developing the area. Once the Division and the developer reach an agreement, the developer must submit a petition to the City Council requesting that an assessment district be created. In addition, the City and developer sign a Cooperation Agreement which defines the general rights and obligations of the City and the developer. These agreements usually require the developer to make a

cash deposit to cover the estimated expenses the City will incur to establish the assessment district.² These expenses include:

- City staff engineering costs,
- property title reports,
- property appraisals,
- City Attorney document review,
- publication and printing costs,
- bond circular printing and mailing, and
- application fee for bond rating.

If the project terminates at any time during the process of district formation, the City may use the deposit to recoup all of its incurred expenses and refund any residual to the developer. Public Works accumulates expenses incurred during district formation in a separate General Fund project account.

Proximate to the signing of the Cooperation Agreement, the City Council adopts a Resolution of Intention to Make Acquisitions and Improvements. The Resolution of Intention describes the work to be done, the geographical boundaries of the assessment district, and the general terms and conditions for performing the work. In addition, the resolution cites the authorizing provisions of the California Streets and Highways Code that apply to the proceedings that the City intends to follow with respect to issuing bonds, assessing the benefited property, and disposing any surplus monies in the Special Assessment District Fund. Further, the resolution directs that an Engineer's Report be prepared and filed.

² See FINDING IV for a further discussion of the adequacy of developer deposits.

The Engineer's Report describes the project in detail. It contains a description of the project; boundary map and assessment diagrams; plans, specifications and rights-of-way easements to be acquired; the formula for allocating the total assessment; and the estimated total cost of the project.

Bond Financing

Following the required public hearing and formation of the assessment district by the Council, Public Works notifies Finance to start the process for issuing the required bonds. Normally, fifteen- or twenty-year serial bonds are issued. Finance determines whether the bonds will be sold by negotiation or put to bid and selects the financial counselor and the underwriter. Finance schedules the bond sale and sets the date for pricing the bonds, if negotiated, or the bidding date.

Before the bonds are sold, the City Council adopts a resolution authorizing the issuance of bonds. After the bonds are priced or put to bid, Council adopts another resolution ordering the sale of bonds. When the bond proceeds are received, Finance records the transaction in a *Special Assessment District Fund*, which reimburses the General Fund for all expenses incurred during the district formation. The City refunds the developer deposit, and construction proceeds.

Collection of Assessments

Finance maintains a Special Assessment Master file. From this file, Finance annually prepares a list of special assessment installments which it transmits to the County for collection. The list contains each property parcel's share of the bond principal and interest that is due for the fiscal year, and includes a one percent collection surcharge. The County keeps twenty-five percent of the collection surcharge as its service fee, and remits the remaining seventy-five percent together with the assessment collections to the City. The City deposits the money in the Debt Service Cash Accounts of the related Special Assessment District Funds to meet debt service payments and deposits the collection surcharge in the General Fund.

Payment of Interest and Maturing Bonds

The City uses two commercial banks, the Bank of America and Security Pacific National Bank (Security Pacific), as paying agents for the payment of principal and interest to bondholders. The Bank of America invoices the City for the required semi-annual debt service payments and for its service fee. The Accounting Division of Finance verifies each invoice against the Debt Service Schedules of the corresponding assessment funds and prepares a Special Payment Demand payable to the agent bank. In addition, Accounting prepares 1) a bank letter directing Security Pacific (the City's depository bank) to pay the Bank of America by wire transfer, and 2) a schedule of assessment funds, account codes and amounts to be charged for the funds transferred. The Special Payment Demand, bank letter and charge schedule are routed to the Treasury Division of Finance for wire transfer processing.

When Security Pacific is the bond paying agent, Accounting initiates the debt service payment from its Debt Service Schedules. Accounting processes debt service payments to Security Pacific the same as payments to Bank of America, with one exception. Since Security Pacific is both the City's depository bank and paying agent, a wire transfer is not needed.

Distribution of Earnings and Fund Surplus

Most Special Assessment District Fund cash accounts are included in the City's investment pool and participate in the earnings of the pool on a pro rata basis.³ Investment pool earnings are calculated and credited to each fund monthly. Finance uses the month-end balances of each cash account to develop the pro rata or sharing ratios. These ratios are applied to the total earnings to be distributed to obtain the amount to be credited to each cash account.

In some cases, a Special Assessment District Fund cash account may have a negative balance (an overdraft). For purposes of calculating the sharing ratios, Finance simply eliminates the negative balance from the calculation, and no interest is calculated or paid to that specific cash account. While these negative cash accounts receive no interest, they similarly are not penalized for having a negative cash balance. (See FINDING I)

When all planned improvements for a Special Assessment District are completed, Public Works reviews the Construction Cash Account in the

³ See FINDING III for a discussion of these cash accounts that are invested separately because of 1986 Tax Reform Act requirements.

District's fund. The Department analyzes every transaction in the Construction Cash Account to correct errors and determine if any surplus exists. When a Construction Cash surplus does exist, the City Council passes a resolution which authorizes refunds to landowners, or effectively reduces landowner's future payments.

Accounting for Transactions and Cost Reimbursements

Finance accounts for and prepares financial statements for Special Assessment District Funds. The General Fund absorbs the cost associated with these activities. The cost of Public Works Department staff in the Assessment Engineering Section is supported by: 1) direct labor charges to assessment districts that are being formed or under construction, 2) tax collection surcharges, and 3) delinquency penalties and segregation fees.⁴

⁴ A segregation fee is a fee that is charged when a property owner wishes to subdivide property in a special assessment district.

SCOPE AND METHODOLOGY

We reviewed the City's Special Assessment District Activities to determine whether adequate controls are in place to ensure that:

- Activities are performed effectively, efficiently and economically;
- Activities comply with applicable laws, regulations, City policies and procedures; and
- Financial and operating information are adequate and reliable.

Our review included inquiries and tests of Public Works and Finance accounting and administrative procedures related to Special Assessment District:

- Formation,
- Financing,
- Collection,
- Debt Service Payments,
- Administrative Costs and Recoveries, and
- Fund Earnings and Surplus Distributions.

Our review focused on Fiscal Year 1987-88. However, we extended our review to prior and current fiscal years as required.

FINDING I

ELIMINATING NEGATIVE CASH BALANCES IN SPECIAL ASSESSMENT DISTRICT FUNDS WOULD INCREASE OTHER CITY FUND INTEREST EARNINGS

Special Assessment District Funds are part of and participate in the earnings of the City's investment pool. Theoretically, each fund in the City's investment pool participates in overall interest earnings on a pro rata basis. However, our review revealed that some Special Assessment District Fund Accounts incur negative cash balances. Since these negative cash balances reduce the interest earnings distributed to the other funds in the City's investment pool, Finance needs to improve its accounting and administrative procedures for Special Assessment District Funds. In addition, Finance should arrange to have Santa Clara County advance Special Assessment District collections to prevent future negative cash balances.

Special Assessment District Funds And The City's Investment Pool

Each Special Assessment District Fund may have up to four principal cash accounts:⁵

- Debt Service Cash, which is funded by assessment collections and used to make semi-annual bond interest and principal payments.

⁵ The Debt Service Cash, Construction Cash and Reserve Cash Accounts correspond to the Redemption Fund, Improvement Fund and Reserve Fund in Special Assessment District Bond Resolutions.

- Construction Cash, which is funded by bond issue proceeds and used for budgeted costs and expenses such as land acquisition and improvements.
- Reserve Cash, which is transferred to Debt Service Cash in the event of delinquent assessment collections; and
- Restricted Cash-Paying Agent, which is used to cover paying agent service fee.⁶

Under the City's interest distribution process each account in the investment pool is pro rated its share of the City's monthly investment pool earnings. Thus, each of the Special Assessment District Fund cash accounts are separately pro rated their share of the monthly earnings. Our review revealed that Debt Service Cash Accounts sometimes incur end-of-the-month negative balances. In addition, we determined that these negative balances reduce the interest earnings of the other funds in the City's investment pool.

Negative End-Of-The-Month Debt Service Cash Account

As of December 31, 1987, the City had 59 active Special Assessment District Funds. Our review revealed that there were negative end-of-the-month Debt Service Cash Account balances for 25 of those 59 funds from July 1987 through December 1987. TABLE I summarizes the Debt Service Cash Accounts with negative end-of-the-month balances during the period of July 1987 through December 1987.

⁶ See FINDING V for a further discussion of this account.

TABLE I

**SUMMARY OF DEBT SERVICE CASH ACCOUNTS
WITH NEGATIVE END-OF-THE-MONTH
BALANCES DURING THE PERIOD OF
JULY 1987 THROUGH DECEMBER 1987**

**DEBT SERVICE CASH ACCOUNT
MONTH END BALANCES**

<u>Fund Number</u>	<u>July 1987</u>	<u>August 1987</u>	<u>September 1987</u>	<u>October 1987</u>	<u>November 1987</u>	<u>December 1987</u>
868	\$(30,694)	\$(30,694)	\$(30,694)	\$(30,694)	\$(30,694)	\$(94,194)
885						(16,750)
922						(903)
929						(8,169)
943	(2,074)	(2,074)	(2,074)	(2,074)	(2,074)	(4,719)
946						(99,147)
947						(2,158)
954	(162,493)	(112,784)	(114,295)	(114,295)	(76,521)	(584,021)
965	(39,406)	(39,218)	(38,730)	(38,730)	(38,730)	(38,730)
970	(120,931)	(120,931)	(120,931)	(120,931)	(120,931)	(106,790)
971						(123,982)
973						(50,944)
975	(26,040)					(113,651)
976						(168,299)
978	(438,077)	(438,077)	(438,077)	(438,077)	(438,077)	(90,279)
979						(267,438)
980				(579,435)	(554,763)	(547,189)
981						(112,439)
983	(566)	(566)	(566)	(566)	(566)	(15,329)
984	(22,987)	(22,410)	(31,634)	(31,634)	(51,834)	(51,834)
985					(139,594)	(220,219)
986	(21,210)	(22,529)	(23,631)	(23,631)	(23,631)	(164,613)
990	(64,922)	(63,060)	(63,060)	(63,060)	(63,060)	(127,621)
993		(1,110,051)				
997		(6,623)	(6,915)	(4,356)		
TOTALS	\$(929,400)	\$(1,969,017)	\$(870,607)	\$(1,447,483)	\$(1,540,475)	\$(3,009,418)

As is shown above, the amounts of Debt Service Cash Account negative balances varied from \$566 per fund to more than \$1.1 million. In addition,

cumulative monthly totals for Debt Service Cash Account negative balances varied from \$870,607 to \$3,009,418.

Reduced Earnings For Other City Accounts

Each Special Assessment District Fund cash account is allocated its share of the City's Investment Pool interest earnings separately. In addition, when a Debt Service Cash Account has a negative balance, the other three Fund Cash Accounts, such as Construction Cash, are allocated their share of interest earnings without reduction for the negative Debt Service Cash Account balance. Further, because negative Debt Service Cash Account balances are not charged interest and are not included in the Investment Pool interest distribution calculation, they effectively reduce the interest earnings that are allocated to the other accounts in the City's Investment Pool. For example, during the six months ending December 31, 1987, the City's Investment Pool earned \$16,885,249. Had it not been for the negative Debt Service Cash Accounts, shown in TABLE I above, the other accounts in the City's Investment Pool would have received an additional \$70,269 in interest earnings for the six-month period.

Inadequate Special Assessment District Accounting And Administrative Procedures And Timing Of County Remittance Of Collections Cause Negative Balances In Debt Service Cash Accounts

Our review revealed that negative end-of-the-month Debt Service Cash Account balances are the result of 1) inadequate Special Assessment District accounting and administrative procedures and 2) timing problems

regarding the County's remittance of Special Assessment District collections to the City.

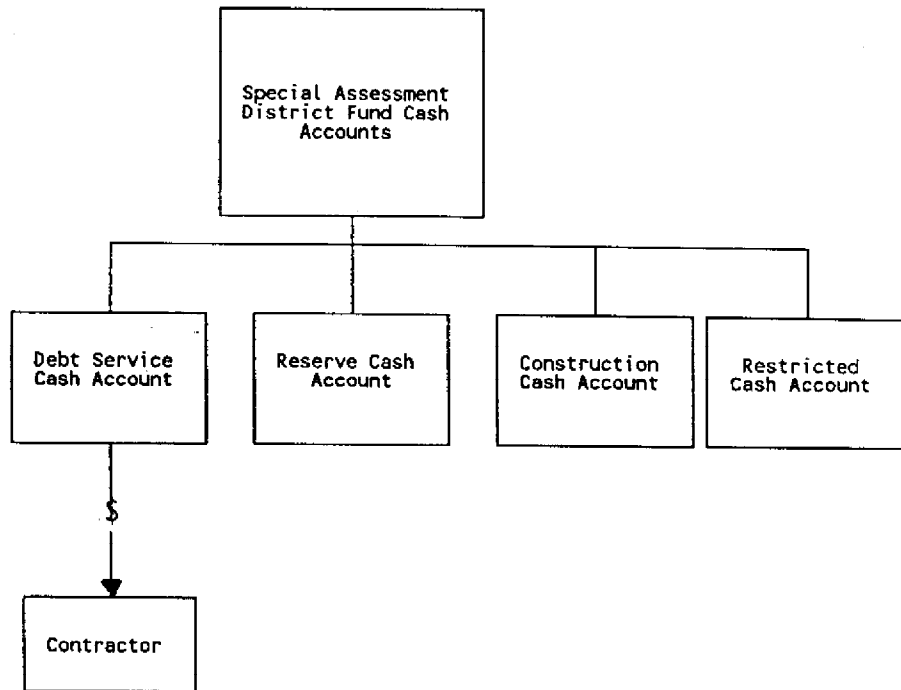
Accounting And Administrative Procedures

The Administration's accounting and administrative procedures for Special Assessment Districts are inadequate and inconsistently applied. Specifically, under the City's accounting system, the Debt Service Cash Account also functions as the primary cash transaction account. In other words, all transactions related to the Special Assessment District Fund Cash Accounts flow through the Debt Service Cash Account first. According to Information Systems and Finance Department officials, the City's computerized accounting system is programmed to put certain transactions into a pre-specified cash account. In the case of Special Assessment Districts, this pre-specified cash account is the Debt Service Cash Account. As a result, each time a Construction Cash Account transaction occurs, such as a payment to a contractor, the payment is initially made out of the Debt Service Cash Account.⁷ At the end of each month, Accounting 1) reviews the Appropriations Report, 2) identifies those construction type expenditures that were made out of the Debt Service Cash Account, and 3) transfers funds equivalent to the total of those expenditures from the Construction Cash Account to the Debt Service Cash Account. This process is illustrated below:

⁷ It should be noted that this practice appears to constitute a technical non-compliance with certain Special Assessment District bond resolutions. Specifically, some of the Special Assessment District bond resolutions state that disbursements from Debt Service Cash Accounts "shall be made exclusively to pay the principal or redemption price of the bonds and the interest due thereon". Therefore, the practice of paying for construction type expenses initially out of a Debt Service Account appears to be at variance with certain bond resolution provisions.

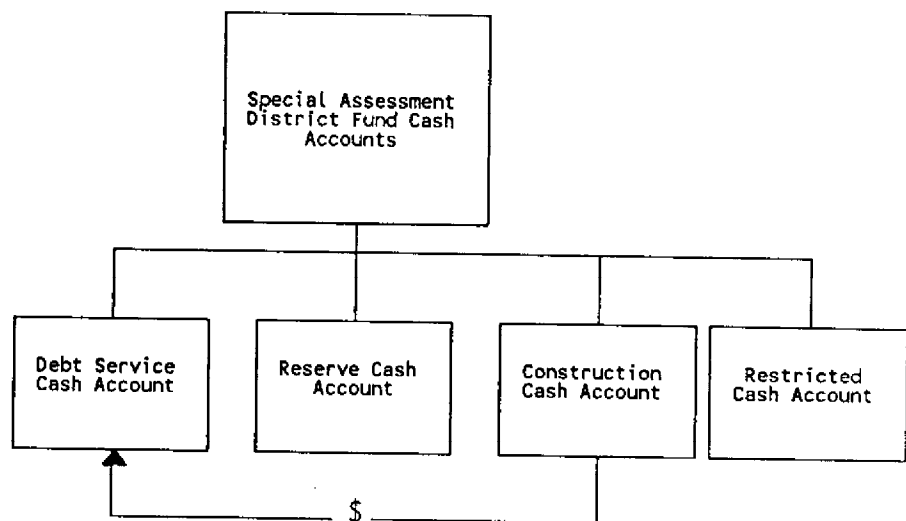
TRANSACTION

CASH PAYMENT MADE
TO A CONTRACTOR



MONTH-END TRANSFER

AT MONTH'S END
ACCOUNTING REVIEWS
THE APPROPRIATIONS
REPORT AND
TRANSFERS
FUNDS EQUIVALENT
TO THE TOTAL OF
CONSTRUCTION TYPE
PAYMENTS MADE
FROM THE DEBT
SERVICE CASH
ACCOUNT



Our review revealed that not all Construction Cash type expenses are listed on the Appropriations Report, causing an insufficient amount of money being transferred from the Construction Cash Account to the Debt Service Cash Account. Consequently, end-of-the-month negative Debt Service Cash Account balances occurred. For example, a \$727,000 court deposit under an eminent domain proceeding was paid out of a Debt Service Cash Account. Because such a deposit does not appear on the Appropriations Report, no transfer was made from Construction Cash and a \$579,000 negative Debt Service Cash Account balance resulted. This Debt Service Cash Account carried a negative balance for four months until Accounting made an appropriate transfer. It should be noted that our audit prompted Accounting to research this particular Debt Service Cash Account and to take corrective action.

Another cause of negative end-of-the-month Debt Service Cash Account balances is that Accounting has not adequately reviewed for delinquent Special Assessment payments. As was noted previously, Reserve Cash is one of the Special Assessment District Fund cash accounts. This account is designed to transfer funds to the Debt Service Cash Account when it has insufficient funds to pay for bond interest and principal because of delinquent payments. During our review, we noted two end-of-the-month negative Debt Service Cash Account balances that could have been eliminated had Accounting transferred available funds from a Reserve Cash Account to a Debt Service Cash Account. These two Debt Service Cash Accounts had negative balances due to delinquent payments of \$139,647 and \$67,975 as of December 31, 1987. The respective Reserve Cash Accounts for these two accounts were \$969,371 and \$125,590. Had Accounting

analyzed these Debt Service Cash Accounts at month's end, they could have transferred funds from Reserve Cash Accounts to Debt Service Cash Accounts and eliminated \$207,622 of negative Debt Service balances.

In addition to Reserve Cash Accounts, the City has a "Special Assessment Revolving Fund". This Fund is designed to purchase property for which assessment payments are delinquent and to pay interest and principal on assessment bonds. As of September 30, 1988, there was \$190,012 in this Special Assessment Revolving Fund. Accordingly, Finance should determine the propriety of using the Special Assessment Revolving Fund in those instances where Reserve Cash Accounts are insufficient to cover delinquent payments.

Timing of County Remittances

Negative Debt Service Cash Account balances are also the result of timing differences with the County. Specifically, the City needs to make bond interest and principal payments sooner than it receives County remittances of Special Assessment District collections.

Special Assessment District payments are due to the County by December 10 and April 10. Currently, the County takes about a month to process, account, and remit to the City its share of these collections. This delay causes a problem for the City when it makes debt service payments for those Special Assessment District bonds that have a January 2 semi-annual

debt service payment date.⁸ Specifically, our review revealed that because of the remittance delay, several of the Special Assessment Districts do not have sufficient funds in their Debt Service Cash Accounts to make the required January 2 payments. As a result, other City funds, in effect, subsidize these Special Assessment Districts.

Obviously, the solution to this problem lies in the County expediting its remittance of the City's December Special Assessment District semi-annual collections. However, according to various County officials, such an option is not practically available. Accordingly, another alternative needs to be developed.

One such alternative would be for the County, by the middle of December, to advance to the City a portion of its expected December Special Assessment District collections. The County could then perform its normal processing and accounting functions and remit to the City its share of the Special Assessment District collections less the amount of the advance. In our opinion, this approach would satisfy the City's needs without exposing the County to risk in that:

- The amount of the advance could be based upon historical collections.
- The advance could be for a portion of the expected collections. An advance of 80 to 90 percent of expected collections should be sufficient.

⁸ Assembly Bill (AB) 891 changed the semi-annual bond payment due dates from January 2 and July 2 to March 2 and September 2, in order to address the timing situation described above. However, AB 891 only affects bonds issued subsequent to June 1985.

- The City could agree to hold the County harmless in the unlikely event an over advance is made. The City could immediately repay the County for any over advancement made.

Currently, the County advances certain property tax payments to the City. Therefore, the above proposal is not without precedent. In addition, the County's exposure in this matter appears to minimal. For example, the County received all but \$376,799 of the \$5,913,904 in City of San Jose Special Assessment District installments that were due in December 1987. This ratio of payments to delinquencies has held fairly steady for the last two years.

It should be noted that on September 16, 1988, the San Jose Finance Director and City Auditor co-authored a letter to the Santa Clara County Director of Finance. This letter proposed that Santa Clara County advance Special Assessment District collections to the City of San Jose as described above. The County had not responded to this letter as of September 30, 1988.

CONCLUSION

The Administration needs to improve its accounting and administrative procedures and arrange to have the County remit Special Assessment District collections sooner. By so doing, negative Debt Service Cash Account balances will be eliminated and the other funds in the City's investment pool will receive additional interest earnings.

RECOMMENDATIONS

We recommend that the Department of Finance:

Recommendation #1:

Develop a procedure whereby Special Assessment District Fund Debt Service Cash Accounts no longer function as cash transaction accounts.

(Priority 1)

Recommendation #2:

Develop a procedure whereby Debt Service Cash Account balances are reviewed each month and appropriate transfers are made from Reserve Accounts or the Special Assessment Revolving Fund to Debt Service Cash Accounts. (Priority 1)

Recommendation #3:

Arrange to have Santa Clara County advance a portion of Special Assessment District collections by the middle of December of each year.

(Priority 1)

FINDING II

AUTOMATING ENTRY OF CASH ACCOUNT BALANCES TO THE MONTHLY INTEREST DISTRIBUTION REPORT WILL IMPROVE EFFICIENCY AND REDUCE THE POTENTIAL FOR ERRORS

In order to distribute monthly interest earnings to the funds in the City's Investment Pool, the Accounting Division manually enters approximately 380 month-end cash account balances onto a computerized spreadsheet. By automating the entry of month-end cash balances, as much as 84 hours of staff time per year would be saved and the potential for manual entry errors would be eliminated.

The Monthly Interest Distribution Process

In order to credit each fund in the City's investment pool with its share of monthly interest earnings, Accounting prepares a monthly Interest Distribution Report. The process of preparing the monthly Interest Distribution Report requires Accounting to enter approximately 340 cash account balances from the Special Combining Trial Balance Report to a Lotus 1-2-3 spreadsheet. Accounting verifies that the right figures were transferred from the Special Combining Trial Balance to the spreadsheet by comparing the balance totals. Accounting also enters approximately 40 gift fund balances from another source. After the fund information is transferred, the Lotus 1-2-3 spreadsheet calculates approximately 600 accounting entries for interest distribution. These accounting entries are entered into the City's General Accounting System.

Opportunities To Automate Entry Of Cash Account Balances To The Interest Distribution Report

Downloading is a process which allows for the transfer of information from one computer system to another. In this case, those cash account balances the Accounting Division requires to calculate each fund's interest earnings can be automatically copied from an Information Systems computer generated report print file to an Accounting Division personal computer. The cash account balances can then be transferred to a Lotus 1-2-3 spreadsheet in order to calculate the interest distribution.

Advantages Of Automating Entry Of Cash Account Balances To The Interest Distribution Report

In our opinion, the cost of automating the transfer of cash account balances to the Lotus 1-2-3 spreadsheet is more than justified in terms of saved staff time. Specifically, by investing \$300 to \$1,150 in one-time costs for software and hardware, Accounting can redirect as much as seven-hours a month in staff time. We estimate Accounting would recoup its one-time investment in less than a year in terms of work hours saved. According to Accounting's General Ledger Supervisor, this saved time could be used to work on other tasks.

It should be noted that our review of the Interest Distribution Reports revealed no instances of account balance amounts being entered incorrectly onto the Lotus 1-2-3 spreadsheet. However, because this is a tedious, manual process, the potential for error is always present. Any such error, should it occur, would result in fund accounts being credited with incorrect

interest earnings. Accordingly, another advantage of automating the transfer of cash account balances is the elimination of potential mismatching of cash balances to account numbers and the resultant inaccurate interest distributions.

CONCLUSION

Automating the transfer of cash account balances from the Special Combining Trial Balance to Accounting's Lotus 1-2-3 spreadsheet is a cost effective means to accurately and more efficiently distribute interest to the approximately 380 cash account balances on the Interest Distribution Report.

RECOMMENDATION

We recommend that the Department of Finance:

Recommendation #4:

Automate the process of transferring cash account balances from the Special Combining Trial Balance Report to the Interest Distribution Report.
(Priority 3)

FINDING III

WRITTEN PROCEDURES ARE NEEDED REGARDING ARBITRAGE FOR SPECIAL ASSESSMENT DISTRICT BONDS

The Tax Reform Act of 1986 requires local governments under certain circumstances to rebate to the Federal Government earnings on bond proceeds that exceed the interest paid on the bonds. Special Assessment District bonds issued since the Tax Reform Act of 1986 are subject to these excessive earnings or arbitrage rebates. Our review revealed that Finance is separately investing some of the Special Assessment District proceeds subject to arbitrage rebates. However, Finance has not developed written procedures regarding which bond proceeds should be separately invested or how these investments should be treated on investment pool interest distribution reports. Without written procedures, the potential exists for erroneous distributions of investment earnings to the 230 funds in the City's investment pool.

The Tax Reform Act of 1986

The Tax Reform Act of 1986 requires local governments to rebate to the Federal Government excess earnings on bond issue proceeds. In other words, if a local government issues bonds, invests the bond proceeds and earns more than it is paying on the bonds, then the local government must rebate the excess earnings, or arbitrage, to the Federal government. The Act also requires the rebate, if any, to be made every five years. The Act applies to Special Assessment District bonds issued subsequent to the passage of the

1986 law. These arbitrage requirements affect Treasury Division's investment procedures and Accounting's interest calculation procedures.

Current Administration Investment Practices

In response to the 1986 Tax Reform Act, the Treasury Division separately invests the Special Assessment District Construction Cash Accounts. The other cash accounts within the Special Assessment District Funds are usually combined with the cash accounts in the City's investment pool. Accounting Division adjusts for the separately invested Construction Cash Accounts when it distributes interest earnings by subtracting from the General Ledger cash totals the accounts which have been invested separately. Our review of two interest distribution reports revealed two errors. These errors occurred when Accounting incorrectly subtracted two Debt Service Cash Accounts from the General Ledger totals and excluded them from the interest earnings distribution. In our opinion, the absence of written procedures regarding separately investing funds subject to arbitrage caused these errors. While the dollar amount of these errors was relatively small, significantly larger dollar errors could occur if one of the major Special Assessment District Fund Accounts was involved. As a result, the potential exists for erroneous distributions of investment earnings to the 230 funds in the City's investment pool.

The U.S. Treasury has not yet promulgated regulations to implement the arbitrage provisions of the 1986 Tax Reform Act. In March 1988, the Assistant Director of Finance-Debt Administration asked three of the City's outside bond counsels 1) which accounts within a fund are subject to the

arbitrage requirements and 2) if the accounts subject to arbitrage need to be invested separately. The bond counsel responses were essentially that all of the Special Assessment District Fund Cash Accounts are subject to the arbitrage rebate with the exception of Debt Service Cash Accounts earning less than \$100,000 a year. In addition, all three bond counsels agreed that there was no prohibition against commingling funds subject to rebate in a common investment pool. However, two of the three bond counsels advised that separate investment of funds would be prudent.

An article on arbitrage in the July 1988, issue of Public Investor, a newsletter of the Government Finance Officer's Association, discusses the need for separate investment.

"At the local level, Treasury could justifiably rule that commingled cash pools are inappropriate for bond proceeds. Many bond proceeds often can be invested in higher-yielding longer-term investments during the construction period. The rest of the investment pool often is invested in liquid money market instruments to meet payroll and disbursement requirements....the investment pool may unfairly subsidize the short-term operating funds that would never be able to make long-term investments to capture higher returns...Nobody knows for sure whether Treasury will regulate this activity, but until the rules are published, some prudent investors are maintaining separate investments--or accounting separately for bond proceeds to avoid being challenged on this practice."

CONCLUSION

The 1986 Tax Reform Act requires local government bond issuers to rebate to the Federal government certain, specified earnings on their tax-exempt bond proceeds. Accordingly, Finance needs to develop written procedures regarding which bond proceeds should be separately invested

and how these investments should be treated on investment pool interest distribution reports.

RECOMMENDATIONS

We recommend that:

Recommendation #5:

The Finance Department develop written procedures regarding which bond proceeds should be separately invested and how these investments should be treated on investment pool interest distribution reports.

(Priority 2)

Recommendation #6:

The Treasury Division separately invest those funds subject to arbitrage under the 1986 Tax Reform Act. (Priority 2)

FINDING IV

OPPORTUNITIES EXIST TO ELIMINATE GENERAL FUND FINANCIAL RISK WHEN ESTABLISHING IMPROVEMENT DISTRICTS

Before a local improvement district is formed, the City establishes a cooperation agreement with a developer. The agreement defines the City and developer roles and responsibilities. Our review of 19 cooperation agreements executed during fiscal years 1981-82 through 1986-87 revealed the following:

- Developer deposits are inconsistently determined and are often insufficient to cover the City's incidental expenses.
- The City incurred incidental district formation expenses before cooperation agreements were approved.

These conditions occurred because Public Works 1) lacks a consistent method to ensure that developers pay for all of the City's incidental expenses, and 2) allows expenses to be incurred against proposed but unapproved projects. As a result, the City incurred losses of \$38,742 over the six-year review period and the City's General Fund was exposed unnecessarily to potential losses of up to \$346,342.

Inconsistent And Insufficient Developer Deposits

With assistance from the City Attorney's office, the Public Works Assessment Engineering Section prepares, negotiates and executes cooperation agreements with developers. The cooperation agreement defines the roles and responsibilities of each participant. Specifically, the

agreement addresses such key issues as property ownership, planned improvements, developer deposits to cover City expenses, City and developer reimbursement for services, and termination rights.

As part of preparing the agreement, Public Works is supposed to project the City's incidental expenses to form the district and conduct the assessment proceedings. The City's incidental expenses on each agreement include, but are not limited to:

- City staff engineering costs,
- property title reports,
- property appraisals,
- City Attorney document review,
- publication and printing costs,
- bond circular printing and mailing, and
- the application fee for the bond rating.

These expenses vary with the complexity and size of the project. The projected expenses should serve as the basis for the developer deposit requirement. Public Works management stated that a general rule of thumb for determining a deposit is one percent (1%) of the estimated project cost.

We found that the developer deposits varied significantly from one agreement to another and were not based on projected expenses or in proportion to the estimated bond revenue required. For example, our review revealed that deposits ranged from \$5,000 to \$40,000. Furthermore, Public Works required a \$10,000 deposit for a \$4 million project, \$40,000 for a \$2.4 million project, and \$40,000 for a \$21 million project. One reason for the differences is that Public Works management believes that where the

City stands to benefit, it is important to be flexible so that deposit amounts do not deter a developer.

In general, the cooperation agreements provide that the City or the developer may terminate the agreement anytime before bond issuance. At termination by either party, the City may offset incurred expenses against the developer deposit before refunding the remainder to the developer. However, if the City's incidental expenses exceed the developer deposit, the General Fund is at risk for that amount.

We found that over a six-year period the General Fund was at risk because the City's incidental expenses before bond issuance significantly exceeded the developer deposits on 13 agreements. The following table summarizes the amount of developer deposits and City expenses incurred before bond issuance for the 13 agreements.

TABLE II

**SUMMARY OF DEVELOPER DEPOSITS AND CITY EXPENSES
INCURRED BEFORE BOND ISSUANCE
DURING THE PERIOD 1981-82 to 1986-87**

<u>Number</u>	<u>Project</u>	<u>Developer Deposit</u>	<u>City Expenses</u>	<u>Expenses Exceeded Deposits</u>
81-166	Oakmead-San Jose	\$40,000	\$100,300	\$60,300
81-168	N. Taylor-Alviso Rt. 237	20,000	42,700	22,700
82-170	Maybury-Berryessa	10,000	36,800	26,800
82-171	North First-Viebrock	15,000	33,900	18,900
83-173	Ringwood Court	10,000	20,200	10,200
83-176	Senter-Wool	10,000	42,900	32,900
83-178	Parkmoor-Lincoln	10,000	27,600	17,600
84-183	Blossom Hill-Snell	5,000	14,700	9,700
84-185	Tennant-Rue Ferrari	20,000	22,000	2,000
84-186	Hostetter-UPRR Track	20,000	37,200	17,200
84-189	North First-Holger Way	40,000	105,200	65,200
84-190	Commercial-Berryessa	15,000	21,200	6,200
86-197	Old Oakland-Fox	<u>6,000</u>	<u>23,900</u>	<u>17,900</u>
	TOTAL	<u>\$221,000</u>	<u>\$528,600</u>	<u>\$307,600</u>

Source: San Jose Public Works Department (unaudited)

As TABLE II shows, for the 13 projects the developer deposits totaled \$221,000 while the City's expenses were \$528,600, a difference of \$307,600. As a result, the City's General Fund was at risk \$307,600 on these projects until the districts were formed, bonds were sold, and the participants were reimbursed. The total value of the bonds issued for these districts was \$50,265,000.

According to Public Works officials, developers are also at risk on district projects. Further, developer involvement may save the City money on those projects the City would have to pay for without developer participation. However, in our opinion, the City's General Fund should not be exposed to loss as a result of developer-initiated district projects.

It should be noted that we did not include in TABLE II a City-initiated project for Tenth and Senter (#83-180). In this instance, the City did not require the developer to make a deposit for the \$7.5 million project. Instead, the developer agreed to pay the first \$100,000 of the engineering consultant's fee and the City agreed to pay the balance, up to \$540,000. While this agreement put the City at risk for this amount, Public Works management defends this action by claiming that 1) the district formation was City-initiated because the City Council wanted the area improved, 2) the City saved money by forming the district with the developer, and 3) the City Council knew of, and approved the General Fund's exposure.

We did find an example of one cooperation agreement arrangement that does protect the City's General Fund from any liability. The North Coyote Valley project requires that the co-developers make a large estimated deposit or deliver to the City an irrevocable stand-by letter of credit in lieu

of all or a portion of the deposit. The letter of credit enables the City to fully recover from each co-developer its respective share of costs.

District Financing in Other Cities

As part of our audit, we contacted the cities of San Diego and Los Angeles to determine how they finance improvement districts. In San Diego, the developer provides the city with a sufficient deposit or letter of credit to cover all costs through bond issuance. If costs exceed the deposit or letter of credit, the city demands the developer provide more funds according to the agreement between the city and the developer.

The City of Los Angeles takes an even stronger position. They do not enter into any agreements with developers. The developer must front all costs of the proposed improvement. As a result, unlike San Jose, San Diego and Los Angeles do not put their General Fund at risk for the development of improvement districts.

Expenses Incurred on Unapproved Projects

Public Works incurred incidental expenses on five projects cancelled or postponed before an approved cooperation agreement was executed. For four of the five projects, planning expenses totaled \$2,742. Incurring minimal expenses at the beginning of a project is understandable. However, the cost of the postponed North First-Taylor Street Improvement District (#83-177) exceeded \$66,000. Although the developer made a \$30,000 deposit, the City is still at risk for at least \$36,000 on this project.

Public Works staff stated that projects can be cancelled or postponed for a variety of reasons. These include reduced project marketability, lack of developer funds, and difficulty obtaining permits. In the case of the North First-Taylor Street project, Public Works management stated negotiations were suspended because the developer did not believe that the market conditions were suitable for his proposed development. The official further added that the developer will probably resume his project at some time in the future. At that time, they will negotiate an agreement which requires a deposit sufficient to cover the City's expenses to date. However, until the agreement is consummated, the City's General Fund has incurred a loss for at least \$36,000. Therefore, as of September 30, 1988, the total loss to the General Fund for these five projects is at least \$38,742.

Further discussions with Public Works staff reveal that they recognize the potential General Fund liability. They are considering the use of a less formal interim agreement to authorize project expenses before a cooperation agreement is formulated.

CONCLUSION

Over the six-year review period, the City's General Fund suffered losses of \$38,742 for City expenses incurred in the formation of local improvement districts and was exposed unnecessarily to additional losses of up to \$346,342. This situation occurred primarily because Public Works lacks a consistent method to ensure that developers pay for all of the City's incidental expenses. Other major cities use methods that do not put their General Fund at risk for such projects. In addition, Public Works authorized expenses to be incurred against proposed but unapproved projects.

RECOMMENDATIONS

To eliminate General Fund financial risk when establishing local improvement districts, we recommend that the Public Works Department:

Recommendation #7:

Establish a cooperation agreement provision that requires developers to advance funds on demand to cover the City's incidental expenses on each project. This may include establishing an irrevocable letter of credit with developers on each project. (Priority 1)

Recommendation #8:

Develop a brief letter of agreement to authorize expenses before a formal cooperation agreement is executed. The Department should discontinue the practice of incurring expenses incidental to a proposed district unless there is a letter of agreement or approved cooperation agreement. (Priority 1)

FINDING V

IMPROVED MONITORING COULD ALLOW THE GENERAL FUND TO RECOVER AN ESTIMATED ADDITIONAL \$100,000 PER YEAR IN SPECIAL ASSESSMENT DISTRICT ADMINISTRATIVE COSTS

Our review of the City's Special Assessment District administrative functions revealed that the City incurs substantial costs to administer Special Assessment District bonds. These costs include Public Works and Finance personnel costs and payments to bond paying agents. In 1986-87, the City spent approximately \$100,000 more to administer Special Assessment District bonds than it collected in fees and penalties. This occurred because:

- The costs to administer Special Assessment Districts and the related revenues are not identified in the General Fund's financial statement.
- Provisions of State law create uncertainty as to whether the City can fully recover its costs to service Special Assessment District bonds.

Finally, Finance should investigate transferring \$234,050 from the Special Assessment Districts' Restricted Cash-Paying Agent Accounts to the General Fund as a means of paying semi-annual fees to Special Assessment District bond paying agents. Absent that option, Finance should use the accounts directly to pay the bond paying agent fees.

Functional Phases of Special Assessment Projects

Special Assessment District projects basically consist of two functional phases: 1) bond issuance and project construction, and 2) assessment collection and bond repayment. The first phase is relatively short in duration, perhaps lasting one to five years. The second phase may extend as long as the term of the bonds, up to twenty years. In terms of administrative costs, the second phase represents a significant commitment of City resources which may not be fully recoverable.

Debt Service Administrative Activities

The assessment, collection, and bond repayment functional process is 1) determine the annual assessments and collect them through the County's property tax collection system, 2) pay the principal and semi-annual interest on special assessment bonds, and 3) prepare financial statements and reports on special assessment transactions and funds. Public Works and Finance coordinately perform these basic activities. Specifically, Public Works:

- prepares the assessment rolls for new improvement districts,
- prepares the reapportionment of assessment rolls for parcels that are split into two or more parcels after the initial assessment (called segregations),
- reviews delinquent accounts and arranges special payment schedules for delinquent property owners, and
- arranges for the City Attorney to foreclose on property when special assessments are not paid.

As part of its responsibilities, Finance:

- maintains the assessment rolls,
- notifies the County of the installment amounts to be collected from the property owners,
 - receives and records all assessment payments,
 - receives the delinquency list from the County,
 - pays the bond paying agent, and
 - prepares the annual financial reports of Special Assessment District Funds.

Debt Service Revenues and Costs

The City attempts to recover its Special Assessment District debt service costs primarily by applying a one percent surcharge on the assessment installments collected from property owners. As the collecting agent, the County keeps twenty-five percent of the surcharge and remits the remaining seventy-five percent to the City. In addition, the City receives other revenues in the form of 10% penalties on property owner late payments, segregation fees, and fees for bond calls. In fiscal year 1986-87, Public Works identified the City revenues from these sources at \$142,504.93, consisting of the following revenues:

Surcharge on Special Assessment	\$ 90,790.66
Installments (3/4 of 1%)	
Penalties on Late Payments ⁹	48,414.27
Segregation Fees (\$40 per Segregation, plus \$10 for each new parcel)	3,000.00
Bond Calls (\$100 per Bond Call)	<u>300.00</u>
TOTAL REVENUES	<u>\$142,504.93</u>

(Source: Public Works Department)

By comparison, the General Fund incurred the following costs in 1986-87 to administer the Special Assessment District debt service function:

Public Works Staffing Costs	\$137,439.72
Finance Staffing Costs	<u>34,864.16</u>
Total Direct Labor Costs	\$172,303.88
Estimated Fringe Costs - 25%	<u>43,076.00</u>
TOTAL PERSONAL COSTS	\$215,379.88
Payments To Special Assessment	
District Bond paying Agents	<u>24,000.00</u>
TOTAL DEBT SERVICE COSTS	<u>\$239,379.88</u> ¹⁰

Based on the above revenue and cost calculations, the City is subsidizing the Special Assessment District debt service administration by approximately \$100,000 per year.

⁹ Net of \$28,977 that was reimbursed to Special Assessment Districts.

¹⁰ This total does not include City-wide overhead costs or non-personal costs.

Criteria For Cost Control and Recovery

A Special Assessment levy imposes a requirement on the direct beneficiaries of public improvements to pay the cost of the improvements. These costs include the cost of financing and constructing the projects and the administrative costs of paying off the debt. The City incurs most of these administrative costs. If the City is to recover its costs, it must have an accounting system that allows the periodic matching of costs with revenues to calculate an appropriate cost recovery rate. In addition, the City must be able to apply that recovery rate once it is determined.

Accounting for Special Assessment District Administrative Costs

City staff and non-personal costs to administer the Special Assessment Districts are paid from and recorded in the General Fund. In addition, Special Assessment District revenues in the form of fees and penalties are also recorded in the General Fund. However, the costs to administer Special Assessment Districts and the related revenues are not identified in the General Fund's financial statement. As a result, the cost to administer Special Assessment Districts cannot be readily matched against revenues and an appropriate cost recovery rate cannot be calculated. We discussed this problem with Finance, and they have agreed to set up the required accounting procedures to more clearly establish and match Special Assessment District administrative costs and revenues.

Legal Status of Surcharges

Uncertainty over the maximum amount of surcharges that the City may legally collect also deters full recovery of Special Assessment District administrative costs. Section 8682 of the California Streets and Highways Code allows California cities to levy, as a surcharge, a maximum of 5% of the amount of collected assessment principal plus interest. However, this levy is not to exceed the City Treasurer's estimate of collection expenses nor in any case exceed eight dollars (\$8) per lot or parcel except with the landowner's written consent.¹¹

Public Works has held discussions with several bond counsels and representatives of the City Attorney's Office on the subject of maximum surcharges with varying interpretations.

To eliminate any uncertainty regarding maximum surcharges, Public Works recommended to the City Attorney in July, 1987 that the City adopt an ordinance which would effectively preempt Section 8682. A written response from the City Attorney is pending; however, during the City Auditor's "Exit Conference" on this audit, the Chief Deputy City Attorney stated that the adoption of a City Ordinance may not be legally possible. Given that a City Ordinance may not be possible, legislative remedies should be sought at the State level.

¹¹ A surcharge of eight dollars per lot or parcel would generate approximately \$19,000 per year.

Restricted Cash-Paying Agent Accounts

During our review, we identified that Finance has established Restricted Cash-Paying Agent Accounts for sixteen of the fifty-nine active Special Assessment District Funds. Based upon discussions with current and former Administration officials, we determined that these Restricted Cash Accounts were established by transferring funds from another Special Assessment District Fund Cash Account, the Construction Cash Account. The purpose of the Restricted Cash Accounts is to pay for the service fees and out-of-pocket expenses of Special Assessment District bond paying agents. Our review revealed that Finance has made very little use of the funds in Restricted Cash Accounts in spite of the fact that as of June 30, 1988, there was \$234,050 in those accounts. Instead, the General Fund has been used to make payments to Special Assessment District bond paying agents.

In our opinion, the Administration should either investigate the propriety of using the funds in Restricted Cash Accounts to make periodic fee payments to Special Assessment District bond paying agents or transferring those funds to the General Fund.

CONCLUSION

The City's costs to administer Special Assessment District bonded indebtedness exceeds the revenues generated. This occurs because the City lacks procedures to match Special Assessment District administrative cost and revenues and to calculate appropriate recovery rates. In addition, the City's ability to collect increased Special Assessment District revenues is

hindered because the maximum surcharge the City may levy is unclear. Our analysis revealed that the City is recovering approximately \$100,000 per year less than it is spending to administer Special Assessment Districts. Accordingly, the City needs to improve its cost monitoring system and resolve the legal issues relating to surcharges on Special Assessment Districts. Finally, we determined that Finance should investigate the possibility of transferring \$234,050 in Restricted Cash-Paying Agent Accounts to the General Fund as a means of paying semi-annual fees to Special Assessment District bond paying agents.

RECOMMENDATIONS

We recommend that the Finance Department:

Recommendation #9:

Establish procedures for Special Assessment District administrative costs and revenues that would:

- readily identify costs and revenues related to Special Assessment Districts, and
- Provide for periodic summarization and comparison of costs and revenues. (Priority 1)

Recommendation #10:

Investigate the propriety of either using the funds in Restricted Cash-Paying Agent Accounts to make periodic payments to Special Assessment District bond paying agents or transferring those funds to the General Fund. (Priority 1)

Finally, we recommend that the City Manager:

Recommendation #11:

Initiate a process to effect an amendment in the California Streets and Highways Code that would allow the City full recovery of its costs in administering its special assessment districts. (Priority 1)

OTHER PERTINENT INFORMATION

Status Of The North Coyote Valley Project

The City has one unique cooperation agreement arrangement that requires the co-developers to advance all funds required to establish the improvement district. The North Coyote Valley project is the first to combine a development agreement with a cooperation agreement. The development agreement provides the co-developers with assurances that over a 10-year period the proposed development will be consistent with the City's General Plan. The arrangement requires the co-developers to bear all of the project's engineering and construction costs. This protects the City's General Fund from any liability.

The North Coyote Valley project involves a group of co-developers including Apple Computer Inc., Tandem Computers Inc., Campus Park Associates, Santa Teresa Associates and Coyote Valley Associates. Based on gross acreage owned, each co-developer was required to advance the following respective shares of the total required deposit:

Apple Computer Inc.	\$ 702,320
Tandem Computers Inc.	508,927
Campus Park Associates	1,189,873
Santa Teresa Associates	2,260,148
Coyote Valley Associates	<u>212,732</u>
Total Required Deposit	<u>\$4,874,000</u>

The arrangement further allows the co-developers to make cash deposits or establish an irrevocable stand-by letter of credit in lieu of all or a

portion of such deposits. The co-developers each established a letter of credit, but never used them. Instead, each co-developer chose to make advance deposits. Accordingly, the City invoiced each co-developer until their full share was deposited.

During our audit, we reviewed the project's developer deposits, interest earned and City expenses to ensure compliance with the agreement. We found that from March 1985 through September 1987, co-developer deposits and interest exceeded \$5.3 million, while City expenses approximated \$4.3 million. At the co-developers' request, the City stopped billing them until the excess deposits were consumed. The City continued to monitor deposits, interest and expenses.

As of August 1988, the deposit balance was reduced to approximately \$100,000. Given the size of the deposit balance, Public Works billed the co-developers in advance for work projected through November 1988. According to the Public Works, City staff will not start any new work on the North Coyote Valley project until the co-developers advance additional funds. While this may slow down project progress, it ensures that the General Fund is not at risk.

Public Works limited their advance requests because progress on the North Coyote Valley project has been slow. Delays have resulted because the City has been unable to obtain the required environmental permits from the U.S. Army Corps of Engineers. Once these permits are issued, the City plans to renew the letters of credit to expedite project progress.

Our discussions with Public Works staff indicate that their intention is to ensure that the City's General Fund does not incur any liability for this project.

Click On The Appropriate Box To View Item

